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No. 01-147

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 2001

SECURITIES AND EXCHANGE COMMISSION,
Petitioner,

v.

CHARLES ZANDFORD,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

APPENDIX TO
BRIEF FOR THE RESPONDENT IN OPPOSITION

18 pp

STATEMENT THAT THE PANEL DECISION CONFLICTS WITH DECISIONS OF THE SUPREME COURT AND THAT THE ISSUE SOUGHT TO BE REVIEWED IS OF EXCEPTIONAL IMPORTANCE

In this civil law enforcement action brought by the Securities and Exchange Commission, the defendant, a securities salesman, in a series of transactions sold a customer's securities while secretly intending to convert the proceeds of those sales to his own use. He misappropriated a total of $343,000 from his customer's securities account. On the basis of this clearly fraudulent conduct -- his repeated failure to disclose to his trusting customer that he intended to convert and was converting the proceeds of each sale -- he was convicted of thirteen counts of wire fraud. His conviction was affirmed by this Court. United States v. Zandford, 110 F.3d 62 (Table), 1997 WL 153822, at *1 (4th Cir. 1997). Yet, in this civil action brought by the Commission alleging the same fraudulent securities sales, a panel of this Court held in the attached opinion that the defendant's fraud was not committed "in connection with the purchase or sale of any security" and therefore was not prohibited by the antifraud provisions of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. 240.10b-5. See Statutory Appendix hereto.

The panel's holding is contrary to the holdings and reasoning of controlling decisions of the Supreme Court. It is also contrary to the plain meaning of the statutory language and would seriously undermine the Commission's ability to carry out its responsibility, mandated by Congress, to protect brokerage

firm customers from dishonest brokers. The panel's decision would erase a major protection for investors, and would be contrary to more than half a century of Commission decisions involving the very same type of fraud. 1/

In holding that the defendant's fraud was not in connection with a sale of securities, the panel erroneously separated the fraud from the sale of securities. The panel stated that the "fraud lay in absconding with the proceeds," while there is "no suggestion that the sales themselves were conducted in anything other than a routine and customary fashion." Opp. at 7-8. This is the precise reasoning that was rejected by a unanimous Supreme Court in Superintendent of Insurance v. Bankers Life & Casualty Co., 404 U.S. 6 (1971), in holding that Section 10(b) was violated by a misrepresentation that a corporation selling bonds would receive the proceeds, when insiders actually intended to misappropriate the proceeds for their own use. The panel's attempt to distinguish Bankers Life on the ground that fraud by omission in this case somehow constitutes a lesser "connection" with the sale than fraud by false statement in Bankers Life has no support. The panel's bifurcation of the fraud and the sale is also contrary to the Supreme Court's decision in United States v. O'Hagan, 521 U.S. 642 (1997). The Court held in O'Hagan that the "in connection with" requirement was satisfied by the defendant's deception of a nonparticipant in the defendant's subsequent securities transactions.

1/ See, e.g., Calvert Sec. Corp., 35 SEC 141 (1953); D.S. Waddy & Co., 30 SEC 367 (1949).

AVAILABLE

The panel's expressed desire to avoid federalizing misconduct it believed should be relegated to state tort law was based on a misreading of the Supreme Court's decision in Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977), and conflicts with the Supreme Court's decisions in both Bankers Life and Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083 (1991). Santa Fe's concern over the encroachment of federal law into areas traditionally regulated by state law was limited, as the Court later made clear in Virginia Bankshares, to situations where there is no deceptive conduct. The irrelevance of state law was also expressly made clear in Bankers Life. The standards for securities fraud are of federal origin, having been specifically enacted by Congress to address the special needs for investor protection occasioned by investments in securities. See Section 2 of the Exchange Act, 15 U.S.C. 78b.

The issue on which the Commission seeks rehearing -- whether the defendant's failure to tell his customer that he intended to convert the proceeds of each of the securities sales was "in connection with" those sales -- is a matter of exceptional importance. Section 10(b) and Rule 10b-5 are key provisions upon which the Commission relies in virtually every case in which it seeks injunctions or other judicial remedies, or imposes administrative sanctions, against persons who have engaged in fraudulent conduct. The panel decision erroneously restricts the scope of these provisions in contravention of the statutory

language and Supreme Court precedent and, unless set aside, will seriously weaken the safeguards that Congress enacted to protect investors.

ARGUMENT

ZANDFORD'S FRAUDULENT CONDUCT -- HIS FAILURE TO DISCLOSE HIS INTENT TO CONVERT THE PROCEEDS OF EACH SALE -- WAS "IN CONNECTION WITH THE PURCHASE OR SALE OF A[] SECURITY."

A. The Panel Erred in Viewing Zandford's Sales of Securities as Separable from His Fraud.

1. Zandford, a securities professional, deceived his customer when he sold his customer's securities without disclosing his intent to convert the proceeds to his own use.

The panel decision states that to satisfy the "in connection with" requirement, "'the fraud must have been integral to the * * * purchase or sale of the security.'" Op. at 7 (quoting Flickinger v. Harold C. Brown & Co., 947 F.2d 595, 598 (2d Cir. 1991)). The panel, however, erred in applying that principle. The error stems from the panel's apparent conclusion that Zandford's deception was his misappropriation of the proceeds of the sales of his customer's securities. In fact, Zandford's deception was his failure to disclose to his customer, as he had a duty to do, that he was selling the securities for the purpose of misappropriating the proceeds. Clearly, that deception was "integral" to the sales. Indeed, Zandford's customer would not have permitted him to sell the securities if Zandford had told him he was planning to steal the proceeds. Moreover, because the deception occurred at the time of the sale, the fraud that is the basis for the Commission's action was complete once the securities were sold.

Fraud occurred when Zandford sold his customer's securities even if he did not make affirmative false statements. As a stockbroker, Zandford had a well-established duty to disclose material information to his customer. Nothing could be more material to a broker's customer than his broker's intention to steal the money realized from the sale of his securities. The broker's duty to disclose his intent is based on his implicit representation to his customer throughout the period of their relationship that he would handle the customer's funds and securities honestly and in accordance with the continuous fiduciary duty he owed to his customer. See Chiarella v. United States, 445 U.S. 222, 228-30 (1980) ("the duty to disclose arises when one party has information 'that the other [party] is entitled to know because of a fiduciary or other similar relation of trust and confidence between them'"). 2/ The existence of the duty to disclose, which Zandford and the panel do not and could not dispute, means that Zandford defrauded his customer as soon as he initiated each of his many improper sales transactions without notifying the customer of the sale and of his intent to convert the customer's assets.

2. The panel's conclusion that Zandford's sales were separate from his fraud is inconsistent with Supreme Court precedent.

Supreme Court precedent establishes that Zandford's fraud

2/ The panel acknowledges that "Zandford breached a fiduciary duty to [his customer]." Op. at 11. See also United States v. Russo, 74 F.3d 1383, 1392 (2d Cir.), cert. denied, 519 U.S. 927 (1996) (broker seeking to benefit from an illegal, self-created scheme has a duty to disclose information).

occurred at the time of the sale, and Zandford's full disclosure to his customer of his reasons for selling the securities would have enabled his customer to prevent him from consummating the sales. Consequently, the general language in Hunt about the adequacy of common law has no application here.

CONCLUSION

The panel decision improperly limited the plain language of Section 10(b) and Rule 10b-5 and misapplied relevant Supreme Court precedent by separating the sale of securities and the customer conversion of the proceeds and by considering whether the customer could bring a common law claim against Zandford. This Court should grant the Commission's petition for panel rehearing or rehearing en banc and affirm the district court order granting summary judgment.

Respectfully submitted,

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UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 99-1733

SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

CHARLES ZANDFORD,

Defendant-Appellant,

On Appeal from the United States District Court
for the District of Maryland

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, APPELLEE

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On March 24, 1999, 22 days after the district court's final order, Zandford filed a motion for reconsideration with the district court. JA 143-45. In this motion, Zandford, once again, requested permission to file a brief opposing the Commission's motion for partial summary judgment. Id. Zandford never filed a motion for enlargement of time to file a notice of appeal. Nevertheless, on May 27, 1999, he filed an untimely notice of appeal. On June 2, 1999, the district court entered an order denying Zandford's motion for reconsideration, nunc pro tunc May 24, 1999. In addition, treating Zandford's motion for reconsideration as a motion for enlargement of time under Fed. R. App. P. 4(a)(5) -- even though the motion made no such request -- the district court ordered that Zandford could file his notice of appeal on or before May 27, 1999.

2/ The Commission did not move for summary judgment on its allegations of excessive trading. As a result, the district court did not address these allegations in its order granting summary judgment. Because the Commission is unlikely to receive any further relief by pursuing its excessive trading claims, the Commission has no intention of taking any further action against Zandford. Consequently, the Commission did not question the district court's decision to enter final judgment even though the Commission moved only for partial summary judgment.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

SECURITIES AND EXCHANGE COMMISSION, Plaintiff,	:	CIVIL ACTION NO. AMD 95-CV-2826
v.	:	
CHARLES ZANFORD Defendant.	:	

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MEMORANDUM OF LAW IN RESPONSE TO DEFENDANT'S MOTION TO CONDUCT LIMITED DISCOVERY

I. Introduction

Plaintiff United States Securities and Exchange Commission ("Commission"), by and through its attorney, Brian Carroll, Senior Trial Counsel, files with the Court this Memorandum of Law in Response to Defendant's Motion to Conduct Limited Discovery. Because the Commission's pending Motion for Partial Summary Judgement, Permanent Injunction, and Disgorgement, with prejudgment interest ("motion for partial summary judgement"), is based upon the collateral estoppel effect of the defendant's criminal conviction, defendant's motion to conduct limited discovery should be denied.

II. Background

On April 19, 1998, the Commission filed with the Court its motion for partial summary judgement. This motion is based upon the collateral estoppel effect of the defendant's criminal

conviction for wire fraud. Defendant's criminal conviction was upheld by the Fourth Circuit of the Court of Appeals. See United States v. Zanford, 110 F.3d 62, 1997 WL 153822 (4th Cir. (Md.)) (a copy of which is attached to the Commission's Memorandum of Law in Support of Plaintiff Securities and Exchange Commission's Motion for Partial Summary Judgment, Permanent Injunction and Disgorgement, with prejudgment interest ("Memorandum"), as Exhibit D.).

Defendant now seeks leave to conduct discovery in order to respond to the Commission's motion for partial summary judgement.

The Commission requested and was permitted until May 22, 1998 to file this response to defendant's motion to conduct discovery.

III. Legal Argument

A. Defendant is Barred from Relitigating Facts Established by His Conviction

The Commission's motion for partial summary judgement is based exclusively on the application of the doctrine of collateral estoppel. Under the doctrine of collateral estoppel[1],

[1] Black's Law Dictionary defines collateral estoppel as follows:

> Prior judgment between same parties on different cause of action is an estoppel as to those matters in issue or points controverted, on determination of which finding or verdict was rendered. E. I. duPont de Nemours & Co. v. Union Carbide Corp., D.C. Ill., 250 F.Supp. 816, 819. When an issue of ultimate fact has been determined by a valid judgment, that issue cannot be again litigated between the same parties in future litigation. City of Joseph v. Johnson, Mo.App., 539

the defendant is barred from relitigating facts and contesting liability on claims in the Complaint based on conduct for which he has already been convicted. Memorandum at pp. 5-7. This doctrine is intended to save courts and litigants from the waste and burden of relitigating issues previously established. Memorandum at pp. 5-7.

Here, defendant seeks, through his request for discovery, to relitigate the facts and issues established by his criminal conviction. This attempt to relitigate, however, is barred by the doctrine of collateral estoppel. Moreover, any discovery by defendant would be irrelevant because the facts and issues relied upon by the Commission in it's motion for partial summary judgement are based upon defendant's criminal conviction, which can not be impeached or undermined.

Finally, defendant fails completely to undermine, by any measure, the applicability of the doctrine of collateral estoppel to this case and its preclusive effect on litigating the facts and issues established by defendant's criminal conviction. Indeed, defendant simply ignores the doctrine of collateral estoppel.

S.W.2d 784, 785.
As a bar to relitigating an issue which has already been tried between the same parties or their privies, it must be pleaded affirmatively. Fed. R. Civil P. 8(c). It is applicable to criminal cases. Ashe v. Swenson, 397 U.S. 436, 443-444, 90 S.Ct. 1189, 1194, 25 L.Ed.2d 469.
Black's Law Dictionary, Fifth Edition, 1979, at p. 237.

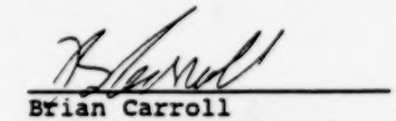
B. Defendant Misapprehends Rule 56

Defendant is not entitled to discovery under Federal Rule of Civil Procedure Rule 56. Because the Commission is relying upon the defendant's criminal conviction and the application of the doctrine of collateral estoppel, defendant discovery would be irrelevant to the pending motion for partial summary judgment. Moreover, defendant's request for discovery fails to comply with the requirements of Rule 56.

IV. Conclusion

For the forgoing reasons, defendant's motion to conduct limited discovery should be denied.

Respectfully Submitted,



Brian Carroll
Senior Trial Counsel
Attorney for Plaintiff
SECURITIES AND EXCHANGE COMMISSION

Date: May 21, 1998

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. CHARLES ZANFORD Defendant.	:	CIVIL ACTION NO. AMD 95-CV-2826

PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MOTION FOR PARTIAL SUMMARY JUDGMENT, PERMANENT INJUNCTION, AND DISGORGEMENT, WITH PREJUDGMENT INTEREST

Plaintiff Securities and Exchange Commission respectfully moves pursuant to Fed. R. Civ. P. 56 for partial summary judgment against defendant Charles Zanford based upon its allegations of misappropriation. The Commission seeks a permanent injunction against Zanford enjoining him from future violations of the securities laws, and disgorgement of ill-gotten gains in the amount of $343,000, plus prejudgment interest of $309,406. In support of its motion, the Commission relies upon the criminal conviction of Charles Zanford in United States v. Charles Zanford (Criminal No. WN-94-0165), the memorandum of law in support of this motion and all exhibits thereto.

Respectfully Submitted,

Brian Carroll
Senior Trial Counsel
Attorney for Plaintiff
SECURITIES AND EXCHANGE COMMISSION

Date: April 15, 1998

BEST AVAILABLE

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. CHARLES ZANFORD Defendant.	:	CIVIL ACTION NO. AMD 95-CV-2826

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFF SECURITIES AND EXCHANGE COMMISSION'S MOTION FOR PARTIAL SUMMARY JUDGMENT, PERMANENT INJUNCTION AND DISGORGEMENT, WITH PREJUDMENT INTEREST

I. Preliminary Statement

Plaintiff Securities and Exchange Commission ("Commission") respectfully submits this memorandum in support of its motion for summary judgment against defendant Charles Zanford ("Zanford") pursuant to Rule 56 of the Federal Rules of Civil Procedure. The Commission also seeks a permanent injunction against Zanford enjoining him from future violations of the securities laws, disgorgement of ill-gotten gains in the amount of $343,000, plus prejudgment interest of $309,406.

The Commission's motion is based on the collateral estoppel effect of Zanford's criminal conviction in the District of Maryland on thirteen counts of wire fraud. 18 U.S.C. Section 1343. (U.S. v. Charles Zanford, Criminal No. WN-94-0165). The facts underlying Zanford's criminal case are identical to those alleged under the Commission's general factual allegations and, more specifically, the misappropriation allegations of the

instant complaint.[1] At issue in the motion, the Complaint charges Zanford with misappropriation of investor funds from an investment account in violation of Section 17(a) of the Securities Act of 1933 ("Securities Act"), 15 U.S.C. Section 77q(a); Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"), 15 U.S.C. § 78j(b); and Rule 10b-5, 17 C.F.R. 240.10b-5, thereunder.

Because the jury has already spoken regarding Zanford's liability, there are no genuine issues of material fact remaining for trial. Zanford had a full and fair opportunity to litigate these claims; he lost and is collaterally estopped from relitigating the same facts. Therefore, the Commission is entitled to judgment as a matter of law.

II. Statement of Facts

A. Zanford's Criminal Trial

The facts underlying Zanford's criminal trial are established by the Superseding Indictment (Exhibit A), Verdict Form (Exhibit B), Criminal Judgement (Exhibit C) and the opinion of the Fourth Circuit Court of Appeals, U.S. v. Zanford, 110 F.3d 62, 1997 WL 153822 (4th Cir. (Md.)) ("Appellate Opinion") (Exhibit D). In addition, a copy of the trial judge's jury

[1] By way of this motion for partial summary judgement, the Commission does not seek judgement on its allegations of excessive trading by Zanford. Complaint at 5-6. Neither the superseding indictment nor the criminal conviction against Zanford addresses these allegations. Hence, the Commission reserves on these allegations.

charge in Zanford's criminal trial is attached. Exhibit E.

On July 25, 1995, following a seven day trial, a jury sitting in the United States District Court for the District of Maryland convicted Zanford on thirteen counts of wire fraud. See Verdict sheet. Exhibit B.

The facts underlying Zanford's conviction are as follows. From May, 1987 to February, 1991, Zanford was employed as a stockbroker in the Bethesda, Maryland office of the brokerage firm of Dominick & Dominick. Appellate Opinion at 1. (Exhibit C) and Superseding Indictment at 1 (Exhibit A). As part of his scheme and artifice to defraud, Zanford convinced William Wood ("Wood"), and his daughter, Diane Okstulski ("Okstulski"), to open a joint investment account at Dominick & Dominick with Zanford acting as their stockbroker. Appellate Opinion at 1. (Exhibit C) and Superseding Indictment at 2 (Exhibit A).

During the period that he dealt with Zanford, Wood was "virtually blind, completely incompetent and medically disabled." Appellate Opinion at 3. (Exhibit C). Wood died in 1991. Appellate Opinion at 1. (Exhibit C). In addition, Okstulski suffered from "multiple personality disorder." Appellate Opinion at 1. (Exhibit C).

As a further part of his scheme and artifice to defraud, Zanford persuaded Wood and Okstulski to entrust him with $419,255, which was deposited in their joint investment account at Dominick and Dominick and intended for the purchase of conservative investments. Appellate Opinion at 1. (Exhibit C)